80-1373

Office-Supreme Court, U.S.
FILED
FEB 10 1981
ALEXANDER L. STEVAS,
CLERK

In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1981

No._____

UTILITY CONSUMERS COUNCIL
OF MISSOURI, INC.,

Petitioner,

v.

PUBLIC SERVICE COMMISSION
OF MISSOURI, and UNION
ELECTRIC CO.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

SAMUEL H. LIBERMAN
BROOKLYN LEGAL SERVICES
CORP. B
105 Court Street
Brooklyn, New York 11201
(212) 855-8003

Attorney for Petitioner

In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1981

No. _____

UTILITY CONSUMERS COUNCIL
OF MISSOURI, INC.,

Petitioner,

v.

PUBLIC SERVICE COMMISSION
OF MISSOURI, and UNION
ELECTRIC CO.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

QUESTIONS PRESENTED

1. Whether regulated utility rates which allow the recovery of revenue sufficient to pay tax expenses which are known to be non-existant in addition to that revenue necessary to pay the real costs of service and provide a reasonable return are in violation of due process and equal protection requirements?

2. Whether Internal Revenue Code provisions conditioning the grant of current tax benefits to regulated utility companies upon regulatory action by state regulatory commissions allowing the recovery of revenue by such companies as though the taxes forgiven were actually to be paid is within the Congressional powers, particularly the taxing power, and whether such provisions unconstitutionally invade the powers reserved to the States.

Page

QUESTIONS PRESENTED..... i

TABLE OF CONTENTS..... ii

TABLE OF AUTHORITIES..... iii

OPINION BELOW..... 1

JURISDICTION..... 1

STATUTORY PROVISIONS INVOLVED..... 2

STATEMENT UNDER RULE 28.4(b)..... 2

STATEMENT OF THE CASE..... 3

REASONS FOR GRANTING THE WRIT

1. THE COURT SHOULD DETERMINE WHETHER OR NOT THE DECISION OF THE COURT BELOW CONFLICTS WITH ESTABISHED CONSTITUTIONAL STANDARDS FOR SETTING REGULATED UTILITY RATES WHICH HAVE BEEN ENUNCIATED BY THIS COURT..... 8

2. THE COURT SHOULD DETERMINE WHETHER CONGRESS HAS PROPERLY EXERCIZED ITS POWERS WITHIN THE CONFINES OF ARTICLE I AND THE TENTH AMENDMENT IN ENACTING INTERNAL REVENUE CODE PROVISIONS WHICH COERCE THE STATE AND FEDERAL REGULATORY COMMISSIONS TO SET UNLAWFUL AND UNCONSTITUTIONAL RATES..... 14

CONCLUSION..... 19

APPENDICES

OPINION AND JUDGMENT OF THE COURT OF APPEALS..... A-1

INTERNAL REVENUE CODE §§46(8) and 167(1)..... B-1

TABLE OF AUTHORITIES

CASES	Page
Acker v. United States	11
Chicago Milwaukee & St. Paul Ry. v. Minn.,	10
EPA v. Brown	16
Fed. Power Commission v. Hope Natural Gas	11
Fed. Power Commission v. Natural Gas Pipeline Co	11
Galveston Elec. Co. v. City of Galveston	11
Munn v. Illinois	12
National League of Cities v. Usery	16
Smyth v. Ames	10
Sonsinsky v. United States	15
Steward Machine Co. v. Davis	15
United States v. Kahriger	15
United States v. Sanchez	15
CONSTITUTIONAL PROVISIONS	
Article 1, Sec. 8	14,
Tenth Amendment	14,16
STATUTES	
IRC §46(e)	2,5,14
IRC §167(l)	2,5,14

OPINION BELOW

The Opinion of the Court of Appeals is reported at 606 SW2d 222 and is attached hereto as Appendix A.

JURISDICTION

The Judgment of the Court of Appeals was entered on September 2, 1980. A timely Motion for Rehearing or Transfer to the Missouri Supreme Court was overruled on October 1, 1980 by the Court of Appeals. A timely Application to Transfer to the Supreme Court of Missouri was denied on November 12, 1980, and this Petition was filed within 90 days of that date. Jurisdiction is involved under 28 U.S.C. §1257(3).

STATUTORY PROVISIONS INVOLVED

Copies of Internal Revenue Code §§46(f) and 167(l) are attached as Appendix B.

STATEMENT UNDER RULE 28.4(b)

Since the proceeding draws into question the constitutionality of IRC §46(f) and 167(l), Acts of Congress affecting the public interest, and neither the United States nor any agency, officer, or employee thereof is a party, it is noted that 28 U.S.C. §2403(a) may be applicable.

STATEMENT OF THE CASE

This case arises from an application for increased electric rates filed by Respondent Union Electric Co. (hereafter Respondent Company) for its service area within the State of Missouri. The rate filing was heard by the Missouri Public Service Commission (hereafter Respondent PSC) which issued an Order on January 19, 1978, which, after correction, became effective on February 2, 1978. Petitioner Utility Consumers Council of Missouri, Inc., an Intervenor representing consumers, particularly residential consumers, of electricity within the service area and throughout the State of Missouri, appealed the order by way of filing a Petition for Writ of Certiorari and Review in the Circuit Court of Cole County, Missouri. The Circuit Court affirmed the PSC order, and on appeal the Missouri Court of Appeals also affirmed.

The appeal was limited to issues

involving the legality of the inclusion of "deferred" income tax items as expenses which Respondent Company can recover from its ratepayers. In the proceedings before the Respondent PSC rates were set in the ordinary manner based on test year information. The Respondent PSC held hearings and based on the evidence found that the Company was entitled to recover a revenue sufficient to pay its proven expenses and provide a fair return on its investment. Neither the rate structure or the reasonability of the allowed rate of return has been appealed.

In computing expenses for the test year, the Respondent Company included certain items of income tax expense which it knew would not have to be paid. The Respondent PSC in its order allowed these fictitious income tax expenses to be included as real expenses. (PSC Order 26 and App. A, Sheet 3). It is not disputed that these taxes will not have to be paid

(PSC Tr. 792-806); although in some instances it is claimed that taxes not paid during the period of the test year computation may be related to a higher amount of income taxes in a future year.

There were several types of deferred taxes included in this case. Deferred taxes which are equal to the taxes which would have been paid if the Internal Revenue Code did not allow accelerated depreciation for tax purposes were allowed (PSC Tr. 792-795). As to these non-taxes it is argued that IRC §167(l) would deny all or part of the benefit if the Respondent PSC refused to include them as expenses. Similarly with Investment Tax Credit given by the Internal Revenue Code, it is argued that the IRC §46(f) would require the denial of the tax benefit if the Respondent PSC refused to include the non-taxes as expenses. (PSC Tr. 792, 3).

Other items of non-tax result simply from Internal Revenue Code allowance of

current tax deductions for expenditures which were properly amortized or placed in construction work in progress accounts for rate-making purposes. There is nothing in the Internal Revenue Code linking these benefits to inclusion of these non-taxes in the ratemaking expense. (PSC Tr. 804-806).

The Court of Appeals held that the Respondent PSC's Order approving the inclusion of non-taxes in the recoverable expense was supported by good and valid reasons and within its zone of allowable discretion. (App. A, 19). Petitioner has contended throughout that allowance of non-taxes amounts to a confiscation of the ratepayers property and a violation of the Constitutional ratemaking standards repeatedly enunciated by this Court, and that the Internal Revenue Code provisions which penalize the utility companies if the regulatory commissions set lawful rates by excluding non-taxes are beyond the legitimate powers of Congress. The PSC and the

Circuit Court did not rule specifically on the questions. The Court of Appeals held that the proposition that only present expense should be charged to ratepayers was flexible enough to allow the "normalization" method if there are good reasons for it, App. A, 12, and that the IRC provisions were not invalid because it was open to Respondents, at least initially, to forego other tax benefits. (App. A 13-14).

REASONS FOR GRANTING THE WRIT

1. THE COURT SHOULD DETERMINE WHETHER OR NOT THE DECISION OF THE COURT BELOW CONFLICTS WITH ESTABLISHED CONSTITUTIONAL STANDARDS FOR SETTING REGULATED UTILITY RATES WHICH HAVE BEEN ENUNCIATED BY THIS COURT.

The practice of allowing normalized non-taxes in current utility rates is followed to some extent in all the jurisdictions of the United States and results in hundreds of billions of dollars of extra revenue being paid annually to the nation's regulated utility companies by their customers. Liberman, Normalized Taxes in Utility Rates: Giving Credits Where None are Due, 30 S. Car. L.R. 703, 706 (1979). This extremely inflationary practice has contributed to rising utility prices affecting every citizen of the nation and hampering the ability of government to provide effective service. The pattern of this subsidization of utility stockholders is one which has encouraged a growing over-capacity in the electric

utility industry and further penalization of ratepayers in the form of the costs necessary to uphold this capacity. (Id., 705, fn. 4).

This Court has never ruled on the serious legal questions as to the validity of this practice. These questions involve fundamental issues as to the proper exercize of governmental power. The charging of non-taxes to current utility ratepayers, even in those instances where there might be higher future taxes related to current tax benefits, amounts to the making of fiscal policy by the regulatory Commission. It is equivalent to an exercize of the taxing power by an administrative body in the guise of carrying on the quasi-adjudicative role of ratemaking. As will be pointed out in Sec. 2 below, there are equally serious issues concerning use of the federal taxing power in a manner which tends to coerce the regulatory agencies into unlawful ratemaking.

This court has long recognized and enforced constitutional limitations on the administration of regulated utility monopolies. The leading case is Smyth v. Ames, 169 U.S. 466, 523-24, 544-47 (1898) where the Court held that rates which fail to provide sufficient revenue and a reasonable return violate the due process and equal protection rights of the utility company by confiscating its property without fair compensation. Similarly the court recognized that rates which provide more than a reasonable return are a confiscation of the ratepayers property. Id., 544, 547; Chicago Mil. & St. P. Ry. v. Minn., 134 U.S. 418, 458 (1890).

Much of the litigation in this area has focussed on defining the zone of reasonability in the rate of return. Although legal definitions and rules have changed, the Court has consistantly re-affirmed the constitutional duty to set rates within the

zone of reasonability. Fed. Power Comm'n. v. Natural Gas Pipeline Co., 315 U.S. 575, 585-6; (1942); Fed. Power Comm'n. v. Hope Natural Gas, 320 U.S. 591, 607 (1944). However, the Court has considered the expense part of the equation also and firmly ruled that fictitious expense cannot be allowed. Galveston Elec. Co. v. City of Galveston, 258 U.S. 388 (1922); Acker v. United States, 298 U.S. 426, 429 (1936).

The question which must be decided is whether this fundamental rule can be avoided by what is essentially an accounting gimmick for including non-existant tax expense. The Constitutional dimension of the problem is emphasized by the admission of all concerned that what is happening is simply a conscription of capital funds from the ratepayers, without any payment of dividend or interest and in some cases without a return of the principle.

This case arises in the area of substantive due process, and for that reason

review may be uncomfortable due to the notion that substantive due process has been totally rejected. For this reason Petitioners emphasize that the Court review of reasonability of rates charged by utility monopolies has never been abandoned and is in fact required by the allowance of monopoly power to a privately held company. Munn v. Illinois, 94 U.S. 113 (1976).

It may be that the Court has in the past 50 years limited its constitutional role in the area regarding oversight of legislative economic regulation. It is still appropriate for the Court to review administrative decisions taken in an adjudicative capacity which have a confiscatory effect. This is particularly true where, as here, the administrative decision is in reality an exercize of legislative power by a non-legislative body.

Moreover, in this case the allowance of unreal expenses makes all the rest of the ratemaking proceeding a farce. If

additional revenue returns can be provided by the allowances of admittedly fictitious expense the whole proceedings as to the proper rate of return and the real costs becomes a meaningless sham. The phoniness of such ratemaking proceedings is apparent to anyone who has attended or participated in one in the past ten years. The results are virtually unreviewable administrative decisions. Review of the issues raised in this case is required by the principle that rates are to be set according to legal rules and procedures, rather than by the unfettered discretion of regulatory bodies.

2. THE COURT SHOULD DETERMINE WHETHER CONGRESS HAS PROPERLY EXERCIZED ITS POWER WITHIN THE CONFINES OF ARTICLE I AND THE TENTH AMENDMENT IN ENACTING INTERNAL REVENUE CODE PROVISIONS WHICH COERCE THE STATE AND FEDERAL REGULATORY COMMISSIONS TO SET UNLAWFUL AND UNCONSTITUTIONAL RATES.

The decision below correctly held that §§46(f) and 167(l) of the Internal Revenue Code do not absolutely require the regulatory commissions to charge the ratepayers for non-taxes. (App. A,14). However, the conditions deny the tax benefits in question to the regulated company in question if the regulatory commissions fails to do so.

This raises questions regarding the limits of the use of Congressional taxing power for non-revenue purposes, which have not been adequately dealt with either by the Court below or any other court.

This court has recognized that Congress may achieve non-tax purposes through a tax law, but it has consistantly required that the tax produce revenue. Moreover in each of these cases the regu-

latory purpose was in aid of regulation of questionable if not illegal activity under state law. United States v. Kahriger, 345 U.S. 22 (1953); United States v. Sanchez, 340 U.S. 42 (1950); Sonsinsky v. United States, 300 U.S. 506 (1937). The tax laws challenged in this case do not produce any revenue to the contrary, they limit the tax revenue which the Internal Revenue Service would otherwise receive. Further, rather than aiding state regulation or being neutral in respect thereto, these laws throw the state regulatory process into chaos making the state proceedings unreviewable and ridiculous.

The decision of this Court in Steward Machine Co. v. Davis, 301 U.S. 548 (1937) has left unresolved important questions as to the power of Congress to intravene in matters otherwise left to the states. In the 44 years since that decision the Court has not determined whether the Congress may

condition private tax benefits upon state governmental activity which has no relationship to the fiscal need for the foregone taxes, where state governmental activity is thereby severely disrupted, where there is no valid purpose for the tax benefit or for its withholding and where the federal tax revenue which might conceivably result from withdrawal of the benefit as a penalty do not relate in any way to the conditioned activity.

More recent decisions indicate that the Tenth Amendment may protect the state and their citizens from such unwarranted upset of their normal governmental processes. National League of Cities v. Usery, 426 U.S. 833, 852 (1976); EPA v. Brown, 431 U.S. 99 (1977)(Per Curiam).

Although these may be difficult questions, they are fairly presented for review in this case and a decision regarding them is necessary in order to resolve the proper relationship of state and federal

government as well as the proper roles of the legislative, judicial and administrative branches of government. Petitioners contend that under the decision of the Court below, the administrative ratemaking body has exercized legislative powers in the most crucial of legislative areas, taxing and fiscal policy, resulting incidentally in extremely inflationary fiscal policy. At the same time the Congress has invaded the adjudicative ratemaking process in an equally unlawful and inept manner, upsetting the whole traditional process.

While it would be improper for the Court to take over either the legislative or ratemaking function, it is entirely within the judicial power to define the limits of those powers, within the context of a ratemaking appeal. The Court below was reluctant to involve itself with these issues because of what it perceived as administrative complexity. Petitioner does not believe that the issues herein are as

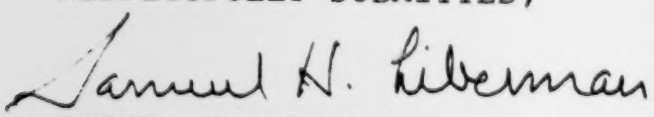
complex as Respondents have attempted to present them. However, even if the issues are complex, the case presents a good illustration of the governmental breakdown which occurs when the Courts fail to perform their duty of keeping each branch within its proper limits. Because of the monumental importance of re-establishing the rule of law in the ratemaking process Petitioners submit that review of this case should be undertaken.

CONCLUSION

For the foregoing reasons, the Petitioner Utility Consumers Council of Missouri Inc. respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Missouri Court of Appeals, Western District entered in this proceeding on September 2, 1980.

Dated: February 9, 1981
Brooklyn, New York

RESPECTFULLY SUBMITTED,



SAMUEL H. LIBERMAN
BROOKLYN LEGAL SERVICES
CORPORATION B
105 Court Street
Brooklyn, New York 11201
(212) 855-8003

Attorney for Petitioner

APPENDIX A

IN THE MISSOURI COURT OF APPEALS

WESTERN DISTRICT

STATE OF MISSOURI, ex rel. UTILITY CONSUMERS COUNCIL OF MISSOURI, INC.,	)	No. WD 31071
Petitioner-Appellant,	)	Opinion Filed September 2, 1980
v.	)	
PUBLIC SERVICE COMMISSION OF MISSOURI and UNION ELECTRIC CO.,	)	
Respondents.	)	

APPEAL FROM THE CIRCUIT COURT
OF COLE COUNTY

HONORABLE JAMES T. RILEY, JUDGE

Before Wasserstrom, C.J., Presiding, Kennedy and Pritchard, JJ.

The sole issue in the present case is the propriety of the Public Service Commission's allowance in a rate case of deductions by Union Electric Company of "normalized" federal and state income taxes, as opposed to the smaller amount of income taxes actually paid during the test year, in arriving at cost of service. The test year ended June 30, 1977. The Commission

allowed a $30,755,498 rate increase effective on February 2, 1978. The appeallant Utility Consumers Council of Missouri, Inc., argues that the Commission improperly allowed the company to treat $24,510,500 in "normalized" or "deferred" federal and state income taxes, and not actually paid out during the test year, as expenses in computing the cost of service.

The difference between the amount of "normalized" taxes allowed by the Commission and the amount of taxes actually paid out by the utility arises from the differences in the accounting treatment of certain items for ratemaking purposes on the one hand and for income tax purposes on the other. Those items are accelerated depreciation, investment tax credit, and certain construction expenses.

Scope of Review.

Before we take up the arguments of the parties, we first take up the matter of the scope of our review. Sec. 386.510, RSMo

1978, says that we review the order or decision of the Commission for "reasonableness and lawfulness". It is really not our business here to weigh the arguments for the "normalization" method which the Commission has ordered, and the arguments for the "flow through" method for which the Utility Consumers Council contends, and to decided which preponderates. That is for the Commission. If the Commission's decision to allow the normalization method is not unlawful, if it is supported by reason, and is not arbitrary or capricious, then it is our task to affirm the Commission's decision. We do not substitute our judgment or our discretion for that of the Commission. The complaining party carries the burden of making a convincing showing that the Commission's order is not reasonable or lawful. State ex rel. Chicago, Rock Island & Pacific Railroad Company v. Public Service Commission, 312 S.W.2d 791, 796 (Mo. banc 1958); Empire Dist. Elec. Co.

V. Cox, 588 S.W.2d 263, 266 (Mo. App. 1979); State ex rel. Beaufort Transfer Co. v. Clark, 504 S.W.2d 216, 217 (Mo. App. 1973); State ex. rel. Cape Girardeau v. PSC, 567 S.W.2d 450, 454 N.4 (Mo. App. 1978).

We not take up in order the arguments of the parties:

Accelerated depreciation.

For income tax purposes, the Internal Revenue Code allows the use of accelerated depreciation, resulting in larger annual deductions in the early years of the life of a depreciable asset and smaller deductions in later years. For ratemaking purposes, a depreciable asset is presumed to depreciate at a constant rate, and the cost basis is deducted ratably over the life of the asset. Respondent's brief furnishes the following comparison of the results of the straight line method (the method used for ratemaking purposes) and a form of accelerated depreciation known as the sum-of-the-years digits method: For

an asset costing $1,000,000, with an estimated useful life of 10 years, the straight line depreciation deduction would be $100,000 per year over the life of the asset. This is the method used for ratemaking calculations. By the sum-of-the-years digits method, used by the company for income tax purposes, the first year depreciation would be $181,818. That amount would decrease each year until in the tenth year the final depreciation deduction would be $18,181.

There is no disagreement about the use of the straight line method to arrive at the correct deduction for ratemaking purposes. The dispute is over the treatment of the income tax "saving", actually a deferral, resulting from the use of the accelerated depreciation method.

By "normalization", which was allowed in the present case, the income tax expense item allowed to be deducted in arriving at cost of service are not the taxes actually

paid, but are the amount which would have been paid had the straight line depreciation method resulted in an income tax deferral of $5,474.678 over the amount which the straight line depreciation method would have produced. This deferred amount was credited to a "deferred tax" reserve. In later years, when the depreciation deduction is less than the straight line method would yield, and the resulting taxes more than the straight line method would have produced, the excess tax will be deducted from the reserve. Over the life of the asset, assuming constant tax rates, the total depreciation deduction and the total income tax reduction resulting therefrom, will be the same by either method. By the accelerated depreciation method, the depreciation deduction will be more in the early years and the income tax less, and the situation will be reversed in later years.

The Utility Consumer Council's criticism of the Commission's decision is

that the deferred taxes which are allowed by the Commission's order to be charged to the ratepayers are actually a fictitious expense. To quote from appellant's brief, their position is as follows: "The income taxes paid by the company to the federal or state government in one year, should appropriately be charged to the customers buying company service in that year . . . 'Deferred' taxes are not expenses at all, but, at best, estimates of future taxes, which are charged to current ratepayers. . . Moreover, the whole idea of deferring expenses so as to 'even them out' over long periods of time, is at odds with the basis system employed by the PSC to set rates. The idea of applying test year information to a ratemaking formula is to try to base rates on actual costs of service at a particular moment".

The "deferred tax reserve", to which the deferred amounts are credited, is an

unfunded reserve. It creates, while it is in existence, a cost-free addition to capital. The appellant says that this is an interest-free loan from the ratepayers to the utility, for the ratepayers have paid it in and the utility does not pay it out. The Commission and the utility answer that the reserved amount is instead a loan from the United States Treasury to the utility. Whichever way one looks at it, it is a sum upon which the utility pays no interest. The amount of it is excluded from the rate base so the rates charged to the ratepayers do not include a return upon the reserved amount. The reserve therefore insures to the benefit of the ratepayers in that the rates do not reflect any cost for the use of the money. This feature provides an immediate benefit to the ratepayers.

Should normalization of taxes not be allowed, and "flow through" required, the substantial tax benefits of accelerated depreciation would be lost to the utility,

Internal Revenue Code, §§167(l) and 46(f); City of Akron v. Public Utilities Commission 51 Ohio St. 2d 27, 364 N.F.2d 869 (Ohio, 1977). In the latter case, the court said: "Since the accounting procedure for normalization uses straight line depreciation which then creates a reserve for the tax obligation resulting from the tax deferral, the effect is that all of the rates and expenses stay the same in any event, but the utility loses the advantage of using the reserve fund as cost-free capital, which it would have if it uses both the accelerated depreciation method and normalization. . .Since we conclude that the Commission's inclusion in the rate-making formula as an expense for the test year of the tax figure arrived at by normalizing tax liability computed by the accelerated depreciation method was neither unreasonable nor unlawful, and that under these facts the determination by the Commission that normalization is in the best interests of

of the ratepayers, the order of the Commission is affirmed." Id. at 870.

The normalization of taxes as ordered by the Commission in this case is widely accepted in rate cases. See Fed. Power Commission v. Memphis Light, Gas & Water Division, 411 U.S. 458 (1973); Cities of Lexington, etc., v. Federal Power Commission 295 F.2d 109, 111 (4th Cir. 1961); Colorado Municipal League v. Public Utilities Commission, 597 F.2d 586 (Colo. banc 1979); City of Alton v. Illinois Commerce Commission, 165 N.E.2d 513, 520 (Ill. 1960); New England Telephone & Telegraph Company v. Public Utilities Commission, 390 A.2d8 (Maine, 1978); Re Hackensack Water Company, 57 N.J. Super. 180, 154 A.2d 212, 219 (1959); City of Akron v. Public Utilities Commission, supra. See also Swiren, Accelerated Depreciation Tax Benefits in Utility Rate Making, 28 U. of Chicago L. Rev. 629 (1961). See also the following regulatory agency cases approving the

normalization method: Re Hudson Water Company, 28 PUR 4th 617, 620 (N.H. Pub. Util. Comm. 1979); Re Southwestern Public Service Company, 27 PUR 4th 302, 315 (N.M. Pub. Serv. Comm. 1978); Re Kansas Power & Light Company, 20 PUR 4th 54, 59 (Kan. State Corp. Comm. 1977); Re Mountain States Telephone & Telegraph Co., 22 PUR 4th 516, 538-40 (Col. Pub. Util. Comm. 1977); Re East Ohio Gas Co., 16 PUR 4th 137, 151 (Ohio Pub. Util. Comm. 1976); Re Arizona Public Service Company, 20 PUR 4th 253, 258-59 (Ariz. Corp. Comm. 1977).

In contending for the "flow-through" system of accounting, by which the income tax component is the amount if income tax actually paid out, the appellant says that the normalization method "is at odds with the basic system employed by the PSC to set rates". It says that "(t)he idea of applying test year information to a rate-making formula is to try to base rates on actual costs of service at a particular moment."

It cites in support of that proposition State ex rel. Capital City Water Company v. Public Service Commission, 252 S.W. 446, 449 (Mo. banc 1923), which held that past losses could not be capitalized and charged to present or future customers. They also cite State ex rel. Valley Sewage Company v. Public Service Commission, 515 S.W.2d 845, 851 (Mo. App. 1974), and State ex rel. Martigny Creek Sewer Company v. Public Service Commission, 537 S.W.2d 388, 394, (Mo. banc 1976), both of which held that customers' contributions in aid of construction must be deducted appellant nor with the general proposition that present expenses are to be charged to present ratepayers. The latter proposition, though, is a very broad one and a very flexible one. It does not prevent the allowance by the Commission of the normalization method of computing the income tax component of the cost of service, if, as we have shown above, there are good reasons for it.

To counter the utility's position, adopted by the Commission, that denying normalization would result in a loss of the tax benefits of accelerated depreciation, appellant Utility Consumers Council attacks the validity of those sections of the Internal Revenue Code which purport to deny accelerated depreciation and investment tax benefits to those companies which do not "normalize" them but which flow them through to net income and hence to the ratepayer. See Internal Revenue Code, §§167(l) and 46(f). Appellant views these sections as requiring normalization by the Public Service Commission. Appellant then argues that this requirement is an unconstitutional intrusion by Congress upon state functions and violative of the Tenth Amendment to the United States Constitution. Leaving aside the effect of a pronouncement by this court in this proceeding, to which the federal government is not a party, that these provisions of the Internal Revenue

Code are unconstitutional and invalid, the answer to the appellant's contention is that its premises is incorrect. The cited sections of the Internal Revenue Code do not require normalization. The choice of normalization or "flow-through" was open to the utility, in the first instance, and to the Commission. It might have rejected normalization and have foregone the tax benefit, if other considerations outweighed the tax advantages to be gained by normalization. Sec. 393, 270.4, RSMo 1978. It chose, however, upon weighing the features of the two methods, to normalize. We find no constitutional infirmity in the Internal Revenue Code sections cited, and we reject the appellant's point.

Investment tax credit.

A regulated utility like other businesses is allowed an income tax credit of 11% of any amount invested in certain qualifying assets. In our case, only the portion above 4% (i.e., the additional

amount authorized by the Tax Reduction Act of 1975) was normalized and is at issue here. The income tax credit amount to $6,911,280. This credit was not "flowed through" to the ratepayers by adding it to net income for ratemaking purposes. It was instead amortized over the life of the property to which it related. The credit was allowable only if normalized. It would have been disallowed if "flowed through". Internal Revenue Code, §§167(l) and 46(f).

Appellant correctly points out that the investment tax credit is an actual tax saving and not a tax deferral. In this respect it is unlike the accelerated depreciation, which results in a tax deferral rather than an outright saving.

Appellant fails to demonstrate how the decision of the Commission to normalize the investment tax credit costs the ratepayers, present or future, anything at all.

Appellant says: "A PSC order contradicting [the provisions requiring normal-

ization in order to claim the investment tax credit] by denying normalization would, at worst, not change the rates, as the ratepayers would pay the same either way" - an argument which says that if the investment tax credit cannot be "flowed through" to the ratepayers, it should be foregone altogether! The ratepayers do, however, gain from normalization of the investment tax credit, as well as the accelerated depreciation and the construction expense deductions, the indirect benefit of an enhanced cash flow for the utility. It is difficult to see how the Commission could reasonably have denied normalization of the investment tax credit. It costs the utility customers nothing, but gives to the utility, to the indirect benefit of the customers, an improvement in cash position. See Southern Cal. Gas Co. v. Public Utilities Comm'n., 591 F.2d 34 (Cal banc. 1979).

Construction expenses.

There is a third category of expenses

which are capitalized for rate-making purposes, but currently deducted from income for income tax purposes. These expenses are interest, property taxes, pensions and other costs charged to construction. They are not permitted, for rate-making purposes, to be "flowed through" to the ratepayer as incurred. Sec. 393.135, RSMo 1978, prohibits the company from earning any return upon facilities before they are actually placed in service. They are added to the costs of the production facilities, then amortized over the life of the facility, beginning when the facility is placed in service. These expenses, currently deducted for income tax purposes, result in a reduction of income taxes. By the tax normalization method, approved by the Commission's order in this case, the income tax saving resulting from the current deduction of these expenses is not "flowed through" at once to the ratepayers, but reduces the cost of the facility to which

the expenses relate. Thus the income tax saving for the test year $12,124,542 - and the construction expenses to which they relate, are both amortized over the life of the facility, beginning with the time the facility is placed in service. There is logic and fairness in this method. The immediate flow-through of income taxes saved, as the appellant would require, would result in a windfall to present ratepayers. Not having to pay the construction expenses, they would yet get the benefits of the income tax deduction resulting therefrom. Later ratepayers, while paying the expenses by way of depreciation, would not have the benefit of any tax deduction therefrom. Cf. Memphis Light, Gas & Water Div. v. Fed. Power Comm'n., 500 F.2d 798, 806-7 (D.C. Cir. 1974).

As in the case of tax savings from acclerated depreciation and from investment credit, normalization does provide for the ratepayers the indirect benefit of an en-

hanced cash flow for the utility.

Conclusion.

We conclude that the Commission's order approving normalization of income taxes in the three areas mentioned, i.e., accelerated depreciation, investment tax credit, and construction expenses, is supported by good and valid reasons. The appellant has not demonstrated either that they are unlawful or unreasonable. The least that can be said for the Commission's order is that it was within the zone of an allowable discretion, which is not be be disturbed upon judicial review. Cf. Tenneco Oil Co. v. Federal Energy Comm'n., 571 F.2d 834, 842-844 (5th Cir. 1978); El Paso Natural Gas Co. v. Fed. Power Comm'n., 449 F.2d 1245 (1971).

"It is obvious that we are confronted in this case with a problem in a special field which requires the exercise of expert skill that has been generally entrusted by state and federal legislation to admini-

strative regulatory tribunals whose decision in the absence of abuse of discretion should be followed by the courts." Cities of Lexington, etc., Ky. v. Federal Power Commission, supra at 114 (4th Cir. 1961).

The judgment of the trial court is affirmed.

All concur.

Don W. Kennedy, Judge

APPENDIX B

INTERNAL REVENUE CODE

Sec. 46(e)

(e) Limitations with respect to certain persons.—

(1) In general.—In the case of—

(A) an organization to which section 593 applies, and

(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (sec. 851 and following),

(2) Ratable share.—For purposes of paragraph (1), the ratable share of any person for any taxable year of the items described therein shall be—

(A) in the case of an organization referred to in paragraph (1)(A), 50 percent thereof, and

(B) in the case of a regulated investment company or a real estate investment trust, the ratio (i) the numerator of which is its taxable income and (ii) the denominator of which is its taxable income computed without regard to the deduction for dividends paid provided by section 852(b)(2)(D) or 857(b)(2)(B), as the case may be.

For purposes of subparagraph (B) of the preceding sentence, the term "taxable income" means in the case of a regulated investment company its investment company taxable income (within the meaning of section 852(b)(2)), and in the case of a real estate investment trust its real estate investment trust taxable income (within the meaning of section 857(b)(2)) determined without regard to any deduction for capital gains dividends (as defined in section 857(b)(3)(C)) and by excluding any net capital gain.

(3) Noncorporate lessors.—A credit shall be allowed by section 38 to a person which is not a corporation with respect to property of which such person is the lessor only if—

(A) the property subject to the lease has been manufactured or produced by the lessor, or

(B) the term of the lease (taking into account options to renew) is less than 50 percent of the useful life of the property, and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

In the case of property of which a partnership is the lessor, the credit otherwise allowable under section 38 with respect to such property to any partner which is a corporation shall be allowed notwithstanding the first sentence of this paragraph. For purposes of this paragraph, an electing small business corporation (as defined in section 1371) shall be treated as a person which is not a corporation.

(f) **Limitation in case of certain regulated companies.**—

(1) **General rule.**—Except as otherwise provided in this subsection, no credit shall be allowed by section 38 with respect to any property which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) **Cost of service reduction.**—If the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection); or

(B) **Rate base reduction.**—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

Subparagraph (B) shall not apply if the reduction in the rate base is restored not less rapidly than ratably. If the taxpayer makes an election under this sentence within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, the immediately preceding sentence shall not apply to property described in paragraph (5)(B) if any agency or instrumentality of the United States having jurisdiction for ratemaking purposes with respect to such taxpayer's trade or business referred to in paragraph (5)(B) determines that the natural domestic supply of the product furnished by the taxpayer in the course of such trade or business is insufficient to meet the present and future requirements of the domestic economy.

(2) **Special rule for ratable flow-through.**—If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) **Cost of service reduction.**—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or

(B) **Rate base reduction.**—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

(3) **Special rule for immediate flow-through in certain cases.**—In the case of property to which section 167(*l*)(2)(C) applies, if the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraphs (1) and (2) shall not apply to such property.

(4) **Limitation.**—

(A) **In general.**—The requirements of paragraphs (1), (2), or (9) regarding cost of service and rate base adjustments shall not be applied to public utility property of the taxpayer to disallow the credit with respect to such property before the first final determination which is inconsistent with paragraph (1), (2), or (9) (as the case may be) is put into effect with respect to public utility property (to which this subsection applies) of the taxpayer. Thereupon, paragraph (1), (2), or (9) shall apply to disallow the credit with respect to public utility property (to which this subsection applies) placed in service by the taxpayer—

(i) before the date that the first final determination, or a subsequent determination, which is inconsistent with paragraph (1), (2), or (9) (as the case may be) is put into effect, and

(ii) on or after the date that a determination referred to in clause (i) is put into effect and before the date that a subsequent determination thereafter which is consistent with paragraph (1), (2), or (9) (as the case may be) is put into effect.

(B) **Determinations.**—For purposes of this paragraph, a determination is a determination made with respect to public utility property (to which this subsection applies) by a governmental unit, agency, instrumentality, or commission or similar body described in subsection (c)(3)(B) which determines the effect of the credit allowed by section 38 (determined without regard to this subsection)—

(i) on the taxpayer's cost of service or rate base for ratemaking purposes, or

(ii) in the case of a taxpayer which made an election under paragraph (2) or the election described in paragraph (9), on the taxpayer's cost of service for ratemaking purposes or in its regulated books of account or rate base for ratemaking purposes.

(C) **Special rules.**—For purposes of this paragraph—

(i) a determination is final if all rights to appeal or to request a review, a rehearing, or a redetermination, have been exhausted or have lapsed,

(ii) the first final determination is the first final determination made after the date of the enactment of this subsection, and

(iii) a subsequent determination is a determination subsequent to a final determination.

(5) **Public utility property.**—For purposes of this subsection, the term "public utility property" means—

(A) property which is public utility property within the meaning of subsection (c)(3)(B), and

(B) property used predominantly in the trade or business of the furnishing or sale of (i) steam through a local distribution system or (ii) the transportation of gas or steam by pipeline, if the rates for such furnishing or sale are established or approved by a governmental unit, agency, instrumentality, or commission described in subsection (c)(3)(B).

(6) **Ratable portion.**—For purposes of determining ratable restorations to base under paragraph (1) and for purposes of determining ratable portions under paragraph (2)(A), the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used.

(7) **Reorganizations, assets acquisitions, etc.**—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the

application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

(8) **Prohibition of immediate flowthrough.**—An election made under paragraph (3) shall apply only to the amount of the credit allowable under section 38 with respect to public utility property (within the meaning of subsection (a)(7)(D)) determined as if the Tax Reduction Act of 1975, the Tax Reform Act of 1976, the Energy Tax Act of 1978, and the Revenue Act of 1978 had not been enacted. Any taxpayer who had timely made an election under paragraph (3) may, at his own option and without regard to any requirement imposed by an agency described in subsection (c)(3)(B), elect within 90 days after the date of the enactment of the Tax Reduction Act of 1975 (in such manner as the Secretary shall prescribe) to have the provisions of paragraph (3) apply with respect to the amount of the credit allowable under section 38 with respect to such property which is in excess of the amount determined under the preceding sentence. If such taxpayer does not make such an election, paragraph (1) or (2) (whichever paragraph is applicable without regard to this paragraph) shall apply to such excess credit, except that if neither paragraph (1) nor (2) is applicable (without regard to this paragraph), paragraph (1) shall apply unless the taxpayer elects (in such manner as the Secretary shall prescribe) within 90 days after the date of the enactment of the Tax Reduction Act of 1975 to have the provisions of paragraph (2) apply. The provisions of this paragraph shall not be applied to disallow such excess credit before the first final determination which is inconsistent with such requirements is made, determined in the same manner as under paragraph (4).

(9) **Special rule for additional credit.**—If the taxpayer makes an election under subparagraph (B) of subsection (a)(2), for a taxable year beginning after December 31, 1975, then, notwithstanding the prior paragraphs of this subsection, no credit shall be allowed by section 38 in excess of the amount which would be allowed without regard to the provisions of subparagraph (B) of subsection (a)(2) if—

(A) the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by reason of any portion of such credit which results from the transfer of employer securities or cash to an employee stock ownership plan which meets the requirements of section 301(d) of the Tax Reduction Act of 1975;

(B) the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan; or

(C) any portion of the amount of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common shareholders.

(l) Reasonable allowance in case of property of certain utilities.—

(1) Pre-1970 public utility property.—

(A) In general.—In the case of any pre-1970 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(i) a subsection (*l*) method, or

(ii) the applicable 1968 method for such property.

Except as provided in subparagraph (B), clause (ii) shall apply only if the taxpayer uses a normalization method of accounting.

(B) Flow-through method of accounting in certain cases.—In the case of any pre-1970 public utility property, the taxpayer may use the applicable 1968 method for such property if—

(i) the taxpayer used a flow-through method of accounting for such property for its July 1969 accounting period, or

(ii) the first accounting period with respect to such property is after the July 1969 accounting period, and the taxpayer used a flow-through method of accounting for its July 1969 accounting period for the property on the basis of which the applicable 1968 method for the property in question is established.

(2) Post-1969 public utility property.—In the case of any post-1969 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(A) a subsection (*l*) method,

(B) a method otherwise allowable under this section if the taxpayer uses a normalization method of accounting, or

(C) the applicable 1968 method, if, with respect to its pre-1970 public utility property of the same (or similar) kind most recently placed in service, the taxpayer used a flow-through method of accounting for its July 1969 accounting period.

(3) Definitions. For purposes of this subsection—

(A) Public utility property.—The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of

(i) electrical energy, water, or sewage disposal services,

(ii) gas or steam through a local distribution system,

(iii) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(iv) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

(B) Pre-1970 public utility property.—The term "pre-1970 public utility property" means property which was public utility property in the hands of any person at any time before January 1, 1970.

(C) Post-1969 public utility property.—The term "post-1969 public utility property" means any public utility property which is not pre-1970 public utility property.

(D) Applicable 1968 method. The term "applicable 1968 method" means, with respect to any public utility property—

(i) the method of depreciation used on a return with respect to such property for the latest taxable year for which a return was filed before August 1, 1969,

(ii) if clause (i) does not apply, the method used by the taxpayer on a return for the latest taxable year for which a return was filed before August 1, 1969, with respect to its public utility property of the same kind or if there is no property of the same kind, property of the most similar kind) most recently placed in service, or

(iii) if neither clause (i) nor (ii) applies, a subsection (*l*) method.

In the case of any section 1250 property to which subsection (*j*) applies, the term "applicable 1968 method" means the method permitted under subsection (*j*) which is most nearly comparable to the applicable 1968 method determined under the preceding sentence.

(E) Applicable 1968 method in certain cases. If the taxpayer evidenced the intent to use a method of depreciation (other than its applicable 1968 method or a subsection (*l*) method) with respect to any public utility property in a timely application for change of accounting method filed before August 1, 1969, or in the computation of its tax expense for purposes of reflecting operating results in its regulated books of account for its July 1969 accounting period, such other method shall be deemed to be its applicable 1968 method with respect to such property and public utility property of the same (or similar) kind subsequently placed in service.

(F) Subsection (*l*) method. The term "subsection (*l*) method" means any method determined by the Secretary to result in a reasonable allowance under subsection (a), other than (i) a declining balance method, (ii) the sum of the years-digits method, or (iii) any other method allowable solely by reason of the application of subsection (b)(4) or (j)(1)(C).

(G) Normalization method of accounting.—In order to use a normalization method of accounting with respect to any public utility property—

(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation.

(H) Flow-through method of accounting.—The taxpayer used a "flow-through method of accounting" with respect to any public utility property if it used the same method of depreciation (other than a subsection (*l*) method) to compute its allowance for depreciation under this section and to compute its tax expense for purposes of reflecting operating results in its regulated books of account.

(I) July 1969 accounting period.—The term "July 1969 accounting period" means the taxpayer's latest accounting period ending before August 1, 1969, for which it computed its tax expense for purposes of reflecting operating results in its regulated books of account.

For purposes of this paragraph, different declining balance rates shall be treated as different methods of depreciation.

(J) Special rules as to flow-through method.—

(A) Election as to new property representing growth in capacity. If the taxpayer makes an election under this subparagraph before June 29, 1970, in the manner prescribed by the Secretary, in the case of taxable years beginning after December 31, 1970, paragraph (2)(C) shall not apply with respect to any post-1969 public utility property, to the extent that such property constitutes property which increases the productive or operational capacity of the taxpayer with respect to the goods or services described in paragraph (3)(A) and does not represent the replacement of existing capacity.

(B) **Certain pending applications for changes in method.**—In applying paragraph (1)(B), the taxpayer shall be deemed to have used a flow-through method of accounting for its July 1969 accounting period with respect to any pre-1970 public utility property for which it filed a timely application for change of accounting method before August 1, 1969, if with respect to public utility property of the same (or similar) kind most recently placed in service, it used a flow-through method of accounting for its July 1969 accounting period.

(5) **Reorganizations, assets acquisitions, etc.**—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

CERTIFICATE OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF KINGS)

I, SAMUEL H. LIBERMAN, being duly sworn, do hereby certify that on the day of February, 1981, three copies of this Petition for Writ of Certiorari were mailed, postage prepaid to Treva Jean Laska, Office of the General Counsel, Public Service Commission, P.O. Box 360 Jefferson City, Missouri 65101, Attorney for Respondent Public Service Commission, to Stewart W. Smith, William E. Jauder and Paul W. Agathen, P.O. Box 149, St. Louis, Missouri, 63166, Attorneys for Respondent Union Electric Co., and on the Solicitor General, Department of Justice, Washington, D.C. 20530. I further certify that 40 copies of this petition were mailed postage pre paid to the Clerk of the United States Supreme Court, Washington,

. D.C., 20543, for filing this 10th day of February, 1981.

Samuel H. Liberman
SAMUEL H. LIBERMAN

Subscribed and Sworn to
before me this 10th day
of February, 1981

Delia Rodriguez
NOTARY PUBLIC

DELIA RODRIGUEZ
Notary Public, State of New York
No. 24-4699150
Qualified in Kings County
Commission Expires March 30, 1981

No. 80-1373

IN THE

Supreme Court of the United States

UTILITY CONSUMERS COUNCIL OF MISSOURI, INC.,
Petitioner,

v.

PUBLIC SERVICE COMMISSION OF MISSOURI, and
UNION ELECTRIC COMPANY,
Respondents.

JOINT BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

C. FLOYD MATHEWS
Suite 1100
1140 Connecticut Ave., N.W.
Washington, D.C. 20036

and

TREVA J. HEARNE
P.O. Box 360
Jefferson City, MO 65102
(314) 751-4273
Attorneys for Respondent Public Service Commission of Missouri

WILLIAM E. JAUDES
STEWART W. SMITH, JR.
PAUL A. AGATHEN
P.O. Box 149
St. Louis, MO 63166
(314) 621-3222
Attorneys for Respondent Union Electric Company

St. Louis Law Printing Co., Inc., 411 No. Tenth Street 63101 314-231-4477

QUESTIONS PRESENTED FOR REVIEW

In the first of its two questions presented for review, Petitioner states that certain taxes "are known to be non-existent". (Petition, p. i). That statement is not correct. As discussed more fully in Respondents' "Statement of the Case", the only question is *when* certain tax benefits should be recognized for ratemaking purposes. Actually, the question raised here by Petitioner involves the now familiar issue of "normalization" versus "flow-through" of tax benefits.

Petitioner's second question for review also includes the inaccurate implication that the utility rates in issue include taxes which will never be paid.

INDEX

	Page
Table of Authorities	iv
Text of Laws Relied Upon	v
Opinion Below	1
Statement of the Case	2
Argument	4
Point I	4
Point II	6
Point III	7
Point IV	10
Conclusion	11
Appendix	A-1
I. List of Typographical Errors in Petitioner's Appendix A	A-1
II. Transcript of Proceedings before the Missouri Public Service Commission, pages 792-806	A-2
III. Paragraph 7 of Petitioner's Motion for Rehearing to the Missouri Public Service Commission	A-15
IV. Petitioner's Notice of Appeal to the Missouri Court of Appeals	A-18

PREVIOUS PAGE WAS BLANK

TABLE OF AUTHORITIES

Cases

California Bankers Association v. Shultz, 416 U.S. 21 (1974) 10

Federal Power Commission v. Memphis Light, Gas and Water Division, 411 U.S. 458 (1973) 6

Memphis Light, Gas and Water Division v. Federal Power Commission, 500 F.2d 798 (Dist. of Columbia Cir. 1974) 7

National League of Cities v. Usery, 426 U.S. 833 (1976). 9

State *ex rel.* Kansas City Transit, Inc. v. Public Service Commission, 406 S.W.2d 5 (Mo banc 1966) 5

State *ex rel.* Williamson v. County Court of Barry County, 363 S.W.2d 691 (Mo 1963) 5

Missouri Constitution

Constitution of 1945 of the State of Missouri, as Amended, Article 5, Section 3 5

Missouri Statutes

Section 386.500(2) Revised Statutes of Missouri 1978 4

Section 512.050 Revised Statutes of Missouri 1978 5

TEXT OF LAWS RELIED UPON

Constitution of 1945 of the State of Missouri, as Amended, Article 5, Section 3:

> **§ 3. Jurisdiction of the supreme court**
>
> Section 3. The supreme court shall have exclusive appellate jurisdiction in all cases involving the validity of a treaty or statute of the United States, or of a statute or provision of the constitution of this state, the construction of the revenue laws of this state, the title to any state office and in all cases where the punishment imposed is death or imprisonment for life. The court of appeals shall have general appellate jurisdiction in all cases except those within the exclusive jurisdiction of the supreme court. (Amendments adopted at special elections Aug. 4, 1970 and Aug. 3, 1976; proposed by Laws 1969, p. 588 and Laws 1976, p. 804)

Section 386.500(2) Revised Statutes of Missouri 1978:

> 2. No cause or action arising out of any order or decision of the commission shall accrue in any court to any corporation or the public counsel or person or public utility unless that party shall have made, before the effective date of such order or decision, application to the commission for a rehearing. Such application shall set forth specifically the ground or grounds on which the applicant considers said order or decision to be unlawful, unjust or unreasonable. The applicant shall not in any court urge or rely on any ground not so set forth in its application for rehearing. (Laws 1913, p. 640, as amended by Laws 1977, p. 595, Sec. 1)

Section 512.050 Revised Statutes of Missouri 1978:

When an appeal is permitted by law from a trial court and within the time prescribed, a party or his agent may appeal from a judgment or order by filing with the clerk of the trial court a notice of appeal. No such appeal shall be effective unless the notice of appeal shall be filed not later than ten days after the judgment or order appealed from becomes final. After a timely filing of such notice of appeal, failure of the appellant to take any of the further steps to secure the review of the judgment or order appealed from does not affect the validity of the appeal, but is ground for such action as the appellate court deems appropriate, which may include dismissal of the appeal. The docket fee of ten dollars in the appellate court shall be deposited with the clerk of the trial court at the time of filing the notice of appeal. (Laws 1943 p. 353 § 129)

No. 80-1373

IN THE

Supreme Court of the United States

UTILITY CONSUMERS COUNCIL OF MISSOURI, INC.,
Petitioner,

v.

PUBLIC SERVICE COMMISSION OF MISSOURI, and
UNION ELECTRIC COMPANY,
Respondents.

JOINT BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

OPINION BELOW

The retyping of the Missouri Court of Appeals' opinion included in Petitioner's Appendix A includes a number of typographical errors. Most of those errors appear to be insignificant. However, Respondents respectfully suggest that anyone wishing to read the opinion below should refer to the reported decision at 606 S.W.2d 222. Alternatively, a list of the changes required in Petitioner's Appendix A is shown in Appendix I of this Brief.

STATEMENT OF THE CASE

Petitioner's "Statement of the Case" includes several allegations which are inaccurate and for which there is no support in the record. First, Petitioner states that "the Respondent Company included certain items of income tax expense which it knew would not have to be paid", and that "It is not disputed that these taxes will not have to be paid..." (Petition, p. 4). At best the contention that the taxes will not be paid is mere argument, and should not have been presented as fact in Petitioner's "Statement of the Case". Even more disconcerting are Petitioner's statements that its allegations in this regard are known to be true, and "not disputed". Respondents have in fact disputed these and similar claims throughout these proceedings, and the sole reference by Petitioner to the Commission transcript pages 792-806 does not support its allegations. The content of those pages is set forth in Appendix II hereto, and consists of certain direct and cross-examination of the Commission Staff witness Mr. Bradley R. Lewis. As Mr. Lewis indicates in answer to the first question on cross, the issue here is whether to pass certain tax benefits on to utlility customers immediately, or to "defer" or normalize them over a period of years. The question is merely one of timing. Mr. Lewis does not state that the "taxes will not have to be paid".

Next, at page 6, Petitioner states as follows:

> Petitioner has contended throughout that allowance of non-taxes amounts to a confiscation of the ratepayers property and a violation of the Constitutional ratemaking standards repeatedly enunciated by this Court, and that the Internal Revenue Code provisions which penalize the utility companies if the regulatory commissions set lawful rates by excluding non-taxes are beyond the legitimate powers of Congress.

As more fully developed in part I of the Argument section of this Brief, Petitioner in fact has not made these contentions "throughout" the proceedings below.

Finally, at pages 6 and 7 Petitioner states with respect to the above-quoted arguments that "The PSC and the Circuit Court did not rule specifically on the questions". As discussed hereafter, these questions were never raised by Petitioner before the PSC. They were raised before the two courts below, at least in different forms, and were addressed in the final opinion below to the extent necessary for their resolution. (See Petitioner's Appendix A-9, A-11 through 14; 606 S.W.2d at 225-226)

The inclusion in a "Statement of the Case" of what at best amounts to mere argument is directly contrary to the Court's Rule 23. Moreover, Petitioner has almost if not completely ignored the requirements of Rule 23(1)(f) with respect to detailing the method by which it raised below the federal questions presented here for review. These defects alone are sufficient reason for denial of the Petition. Rule 23(4)

ARGUMENT

I.

Petitioner Failed To Preserve The Two Questions Raised Here For Review.

Petitioner has raised two questions for review: (1) whether the Respondent Commission's treatment of utility tax benefits for ratemaking purposes is in violation of due process and equal protection requirements; and (2) whether certain conditions established by the Federal Internal Revenue Code on the availability of such tax benefits constitute an unconstitutional invasion of the powers reserved to the States under the Tenth Amendment to the United States Constitution. Neither issue was properly preserved by Petitioner during the proceedings below, and thus the Petition should be dismissed.

In the rate case hearings before the Respondent Public Service Commission, the treatment of the tax benefits in question was scarcely at issue. The *only* testimony offered by Petitioner (or any of the other parties) in opposition to "normalization" was this passing reference in the prepared statement of its one witness: "We also oppose certain matters relating to rate base, income and operating expenses in the Company's filing, in particular the normalization or allowance of tax expenses which are not incurred with relationship to the test year". (UCCM Exhibit 1, p.1). This near-complete lack of a factual record regarding the issues now raised by Petitioner no doubt explains why it must now rely almost totally for its factual support on a law review article written by counsel for the Petitioner. (Petition p. 8-9)

More significantly, the two issues raised here by Petitioner were not presented to the Respondent Commission in Petitioner's Motion for Rehearing. Under Missouri law, matters not raised in the Motion for Rehearing are not preserved for judicial review. Section 386.500(2) Revised Statutes of Missouri 1978;

State ex rel. Kansas City Transit, Inc. v. *Public Service Commission,* 406 S.W.2d 5, 7 (Mo banc 1966). The only section of Petitioner's Motion for Rehearing dealing with the issue of "normalization" was paragraph 7, which is set forth in Appendix III hereto. Appellant did allege in this Motion that normalization violated the Commission's "statutory and constitutional" duty to the ratepayers. However, with respect to the isues raised here Petitioner made absolutely no mention of the Due Process or Equal Protection clauses, or of the Tenth Amendment. And to preserve a constitutional issue in Missouri, "the sections of the Constitution claimed to have been violated must be specified." *State ex rel. Williamson* v. *County Court of Barry County,* 363 S.W.2d 691, 694 (Mo 1963). Therefore, the issues raised here by Petitioner were not properly preserved for review.

After the Commission's order was affirmed by the Circuit Court of Cole County, Missouri, Petitioner then appealed to the Missouri Court of Appeals. (Petition, p. 3). Under Missouri law, the filing of a "Notice of Appeal" is a jurisdictional prerequisite for taking the appeal from the Circuit Court to the Court of Appeals. Section 512.050, Revised Statutes of Missouri 1978. Although Petitioner is now alleging that certain provisions of the Federal Internal Revenue Code are unconstitutional, its Notice of Appeal to the Missouri Court of Appeals, set forth in Appendix IV hereto, specifically stated that "This appeal does *not* involve the validity of a . . . statute of the United States." (emphasis added) In fact, the Missouri Court of Appeals has no jurisdiction to rule on the validity of a United States statute. The state Supreme Court has exclusive appellate jurisdiction in all such cases. Missouri Constitution, Article 5, section 3, as amended.

For the above reasons, Petitoner failed to develop and preserve the two questions raised here, particularly the issue regarding the unconstitutionality of the Internal Revenue Code. Its Petition should therefore be dismissed.

II.

Petitioners First Question For Review Does Not Involve A Federal Question Of Substance Not Heretofore Determined By This Court, Or Decided In A Way Contrary To Applicable Decisions Of This Court.

Petitioner's argument for accepting review of its first question, dealing with the Due Process and Equal Protection issues, is set forth at pages 8-13 of the Petition. In an apparent attempt to bolster the significance of these issues, Petitioner relies upon certain alleged facts for which it cites as authority only a law review article written by Petitioner's attorney. (Petition, p. 8-9). Those allegations are inaccurate, and find absolutely no support in the record in this case. In any event they do not even purport to apply to this particular proceeding.

At page 9, referring to "normalization" of the tax benefits in question, Petitioner then claims that "This Court has never ruled on the serious legal questions as to the validity of this practice". While this Court may not have decided the exact issues raised here by Petitioner, it has in fact approved the "normalization" treatment of utility tax benefits. In *Federal Power Commission* v. *Memphis Light, Gas and Water Division,* 411 U.S. 458 (1973) the precise issue addressed by the Court was whether the Federal Power Commission was precluded by law from allowing a utility to adopt normalization for ratemaking purposes. The Court held that normalization is permissible, which conclusion was based in part at least upon the wide scope of authority generally granted to the Commission in calculating tax expenses for ratemaking purposes. 411 U.S. at 466-467. On remand of this decision the Court of Appeals then concluded as follows:

> "...there is the logical fact that normalization causes current consumers to pay their fair share of tax costs attributable to depreciation, so that future consumers will not be forced to pay higher tax costs when the basis for

depreciation declines. Normalization effects a stabilization in rates between present and future consumers, insofar as rates reflect depreciation."

. . .

"We find no conflict between the rate increase allowed Texas Gas and the 'actual expenditures theory' by which rates of utilities are supposed to reflect actual payments. For while Texas Gas is not currently paying taxes at straight-line rates, it is incurring the liability now to pay increased taxes in the future. Such a method as normalization, whereby current consumers are prevented from forcing future consumers to pay their deferred taxes, does not amount to causing an increase of rates based on fictitious taxes." *Memphis Light, Gas and Water Division* v. *Federal Power Commission,* 500 F.2d 798, 806-807 (Dist. of Columbia Circuit, 1974).

In addition to these two cases, the Missouri Court of Appeals relied upon a number of other Federal and state Courts which have approved normalization. (See Petitioners Appendix A-10, 16, 18; 606 S.W.2d at 225, 226, 227) In contrast, Petitioner has not referred this Court to a single decision which has disallowed normalization. As is apparent, the issue raised here by Petitioner falls far short of the Court's criteria for accepting review of state court decisions. Rule 19(1)(a).

III.

Petitioners Second Question For Review Does Not Involve A Federal Question Which Was Determined In A Way Contrary To Applicable Decisions Of This Court.

Petitioners second question, involving the constitutionality of the Internal Revenue Code, is addressed at pages 14-18 of the Petition. The main thrust of Petitioner's argument is that the tax laws in question would deny certain tax benefits to a utility if those benefits were not normalized, and that inasmuch as the

laws produce no tax revenue, they therefore constitute an invasion of the powers reserved to the states by the Tenth Amendment. (Petition, p. 14-16).

It should be noted first, as Petitioner earlier conceded, that under Federal tax law the availability to a utility of one of the three types of tax benefits is totally independent of state Commission treatment of that tax benefit. (Petition, p. 6). Therefore, the question presented by Petitioner with respect to Federal interference in state utility regulation applies at best to only two of the tax benefits referred to by Petitioner. Also of a preliminary nature, Petitioner's second argument also includes several allegations totally unsupported by the record. Among them: the claim that the tax laws in question "throw the state regulatory process into chaos making the state proceedings unreviewable and ridiculous" (Petition, p. 15); and that "The Court below was reluctant to involve itself with these issues because of what it perceived as administrative complexity" (Petition, p. 17).

On the merits, Petitioner has failed to demonstrate that the Missouri Court's decision is not in accord with applicable decisions of this Court. In the first place, before the Missouri Court the Petitioner had argued that the sections of the Internal Revenue Code in question *required* normalization of the tax benefits. (See Petitioner's Appendix A-13; 606 S.W.2d at 225). The Court of Appeals disposed of the issue by finding that the tax laws in fact do *not* require normalization - a conclusion with which Petitioner now claims to agree (Petition, p. 14). Therefore, by Petitioner's own admission the Missouri Court correctly decided the issue as presented to it by Petitioner.

Even assuming that Petitioner had argued below that the tax law encourages but does not require normalization, Petitioner still has not demonstrated that those laws conflict with applicable decisions of this Court. One basic error is that Petitioner apparently assumes that a tax law achieving non-tax pur-

poses must produce tax revenue in order to be lawful. If that were the case, then other tax deductions furthering such purposes as education and home ownership would likewise be unlawful. Such deductions are specifically designed *not* to produce additional tax revenues. In none of the cases cited by Petitioner at page 15 did this Court hold that a tax law achieving non-tax purposes must produce additional tax revenue. Moreover, even if increased tax revenue is a prerequisite of a valid tax law, that test would in fact be met here. IRC section 167(1) was passed as part of the Tax Reform Act of 1969, Pub. L. No. 91-172, sec. 441, 83 Stat. 625. The accompanying Congressional Reports indicate that this section was intended in part at least to stem the losses in tax revenue resulting from flow-through treatment by some commissions of the tax benefits associated with accelerated depreciation. H.R. Rep. No. 413, 91st Cong., 1st Sess. 132, reprinted in 1969 U.S. Code Cong. & Admin. News 1645, 1782; S. Rep. No.552, 91st Cong., 1st Sess. 132, reprinted in 1969 U.S. Code Cong. & Admin. News 2027, 2204. These same considerations would be applicable also to flow-through treatment of the investment tax credit.

The Court's most applicable pronouncement on the limitations imposed by the Tenth Amendment is *National League of Cities* v. *Usery,* 426 U.S. 833 (1976), wherein the Court ruled unconstitutional the application of federal minimum wage laws to state and local government employees. That case does not support the argument raised here by Petitioner. The distinguishing factor in *National League of Cities* was the Court's finding that the law in question would have a disruptive impact upon government employment practices. *Id* at 846-852. In the present case there is no evidence to support a finding that the tax laws in question have caused any problems whatsoever in state regulation of public utilities. Absent some finding that the federal law has caused a significant disruption of state or local government, *National League of Cities* is inapplicable. Moreover, unlike the minimum wage provisions at issue in *Na-*

tional League of Cities, the tax laws in question here admittedly do not mandate any particular action on the part of state government. (Petition, p. 14) Therefore, none of the decisions cited by Petitioner support its claim that the Internal Revenue Code violates the Tenth Amendment.

IV.

Petitioner Does Not Have Standing To Challenge The Tax Laws On Tenth Amendment Grounds.

The complete lack of evidence in this case regarding a disruptive impact from Federal tax law on state utility regulation leads to one further ground for rejecting Petitioner's Tenth Amendment claim. There is no evidence here of any disruption of state utility regulation in part no doubt because the state is not contending that its regulation is being disrupted. The party making this claim, i.e. the Petitioner, is a private organization which represented certain private interests in a utility rate case (Petition, p. 3). It has no standing to speak for the State of Missouri. To the extent the state is represented here it is through the Respondent Public Service Commission, which opposes Petitioner's position. Respondents therfore contend that the Petitioner does not have standing to raise the Tenth Amendment claim embodied in the second question presented here for review. *California Bankers Association* v. *Shultz,* 416 U.S. 21, 44 (1974).

CONCLUSION

For the foregoing reasons, Respondents Public Service Commission and Union Electric Company respectfully pray that the Court deny the Petition for Writ of Certiorari.

Dated: March 12, 1981

Respectfully submitted,

C. Floyd Mathews
Suite 1100
1140 Connecticut Ave., N.W.
Washington, D.C. 20036
and
Treva J. Hearne
P.O. Box 360
Jefferson City, MO 65102
(314) 751-4273
Attorneys for Respondent
Public Service Commission
of Missouri

William E. Jaudes,
Stewart W. Smith Jr., and
Paul A. Agathen
P.O. Box 149
St. Louis, MO 63166
(314) 621-3222
Attorneys for Respondent
Union Electric Company

APPENDIX

APPENDIX I

List Of Typographical Errors in Petitioner's Appendix A

1. A-2, line 13, change "differences" to "difference"
2. A-4, line 6, change "not" to "now"
3. A-6, line 3, after "method" add the following: "been used in figuring the income taxes. For the test year now under examination, the accelerated depreciation method"
4. A-7, line 16, change "basis" to "basic"
5. A-8, line 15, change "insures" to "inures"
6. A-9, line 3, change "364 N.F.2d 869" to "364 N.E.2d 869"
7. A-9, line 22, change "that" to "concerning"
8. A-10, line 2, after "*Id.*" add "364 N.E.2d"
9. A-10, line 7, after "411 U.S. 458" add "93 S.Ct. 1723, 36 L.Ed.2d 426"
10. A-10, line 11, change "597 F.2d 586" to "597 P.2d 586"
11. A-10, line 12-13, after "*Commission*" add "19 Ill.2d 76,"
12. A-11, line 16, change "if" to "of"
13. A-12, line 3, change "449" to "448"
14. A-12, line 14, after "deducted" add the following: "from rate base. We have no quarrel with the cases cited by the"
15. A-14, line 3, change "premises" to premise"
16. A-16, line 21, after "Comm'n" add "23 Cal.3d 470, 153 Cal Rptr. 10,"

17. A-16, line 21, change "591 F.2d 34" to "591 P.2d 34"

18. A-18, line 12, change "benefits" to "benefit"

19. A-19, line 15, after "*Energy*" add "*Regulatory*"

20. A-19, line 18, change "(1971)" to "(5th Cir. 1971)"

APPENDIX II

Witness Bradley R. Lewis Recalled To The Stand.

Deferred State Income Taxes Issue:

Direct Examination By Mr. England:

Q. Would you state your name for the record, please.

A. Bradley R. Lewis.

Q. And, Mr. Lewis, you have previously testified under oath in this proceeding, have you not?

A. Yes, sir.

Q. And you realize you are still under oath at this time?

A. Yes, sir.

Mr. England: I tender the witness for cross-examination.

Cross-Examination By Mr. Ragsdale:

Q. Mr. Lewis, I direct your attention to Item No. 15 on Page 5 of the Hearing Memorandum on the subject of Deferred State Income Taxes. Can you briefly describe the differences between flow-through and normalizing income taxes?

A. Yes, sir. Any item in question produces an associated tax savings. This tax savings is realized by the Company immediately when they file their return with the Federal Government.

The question is whether to pass this tax savings through the income statement to the customer immediately or to defer it or normalize it over a period of years.

Q. And now does the Staff support normalization of deferred Federal income taxes due to accelerated depreciation?

A. Yes, sir.

Q. And does the Staff sometimes oppose normalization in other items, for instance, payroll taxes capitalized?

A. Yes, sir.

Q. Now, how does the Staff treat investment tax credits, are those normalized generally?

A. Yes, sir.

Q. And in particular, post 1971 additions are normalized, is that correct?

A. Yes, sir.

Q. Can you tell me why, in some instances, the Staff opposes normalization on some items and not on other items?

A. The Commission has ruled that it would grant normalization on a case-by-case basis. It has been the policy of the Staff not to oppose this authorization.

The Commission, in the last rate case, 18, 314, granted Union Electric normalization of the questioned items.

Q. Can you recollect the Staff ever opposing normalization of accelerated depreciation for Federal income tax purposes?

A. Not in a major case.

Q. And do you know why that would be? Do you know of any bar—

A. I would say the main reason is because the Commission has authorized it.

Q. And are you aware of any language in the tax law that perhaps has encouraged the Commission to normalize these items?

A. I am aware of the existence, although I must admit I have never read it.

Q. It is your belief that for Federal income tax purposes, there is a different treatment for investment tax credit and accelerated depreciation because of the language in the tax law, than there are for items such as payroll taxes normalized?

A. Would you repeat that?

Q. Is it your belief or do you have a knowledge that there are, perhaps, there is language in the tax law that would lead to normalization of investment tax credit and accelerated depreciation that does not exist in regards to other items such as payroll taxes, capitalized?

Mr. Smith: Your Honor, I am going to object to this. I think we are asking this Accountant to give us legal conclusions, to interpret tax laws for us.

Mr. Ragsdale: I was generally asking his information about the tax law, that's true, I am not asking whether it is correct.

Examiner Reimnitz: I think he can answer that question. It will be overruled.

Witness Lewis: I would repeat my answer before by saying that I am aware of the existence of that, but I have never read it myself.

By Mr. Ragsdale:

Q. Is normalization of taxes similar to, perhaps can be characterized as collection of taxes that will be payable by the Company to the taxing authorities sometimes in the indefinite future?

A. Not at all.

Q. Could you tell me where that statement is incorrect?

A. Normalization and flow-through, to the best of my knowledge, doesn't affect taxes payable. The current taxes payable is the same, it is how this benefit is flowed to the customers.

Q. I understand. What I am talking about is the collection of expenses that would be associated with those taxes for rate-making, now, would normalization, it may be described as the Company collecting those tax expenses from the ratepayers that it will not incur in the immediate future, or during the test year?

A. The way you have phrased that, I really don't agree with you.

Q. Does not normalization increase the Company's tax expense for rate-making purposes over what it actually pays the taxing authorities?

A. The total income tax expense is increased.

Q. Does normalization create a tax expense for rate-making purposes that exceeds the Company's actual tax liability to the taxing authorities?

A. In most cases total income tax will exceed current income tax, I think I would say yes.

Q. And does this create a positive cash flow for the Company?

A. Yes, sir; it is increased.

Q. And for each dollar of increased cash flow to the Company from normalization, does it require $2 from the customer in his rates?

A. Yes, sir.

Q. Does the effect of normalization provide the Company a method of raising capital?

A. I question the word "raising" but to have additional cash.

Q. And cash could be equated to capital?

A. Well, whether you say it's intentional or not, I think it stems back to the items which create the deferral, and I don't think they raised those.

Q. I didn't mean to say intentional, I said, is the effect of normalization the creation of additional capital for the Company?

A. Additional cash.

Q. Now, for the Company to get a million dollars of cash or capital through normalization, it requires $2 million in rates, is that correct?

A. Yes, sir.

Q. Do you know what the cost would be to the Company if they were to go into the capital market, the external capital market to raise this million dollars?

A. I can't give you an exact figure. I would say my nearest guess would be eight and three-quarters or nine percent, but that's just an estimate. That's a long-term debt.

Q. A long-term debt. So the interest costs would be something less than $90,000?

A. For a million dollars?

Q. For a one-year period?

A. Yes, sir.

Q. Now, if items are flowed through, then the tax expense for rate-making purposes would be identical to the tax expense appearing on the Company's tax returns?

A. If we assume the same adjustments to related expenses and revenues.

Q. And can you tell me how much deferred State income taxes were normalized by the Company in the test year, in regards to the Missouri operations?

A. I have that information, but it is not split in the State income taxes. I can get that for you.

Q. Can you get that for me and provide it to me on the record at a later time?

A. Yes, sir.

Mr. Ragsdale: I believe that concludes my questions, Mr. Examiner.

Mr. England: May I ask you, Mr. Ragsdale, what your last question was, for the purposes of supplying you with an answer later?

Mr. Ragsdale: I would like to know the deferred State income taxes normalized that would be allocated to Missouri in the test year.

Mr. England: Thank you.

Mr. Ragsdale: I did say State income taxes, didn't I?

That concludes my questions.

Examiner Reimnitz: Mr. Liberman.

Cross-Examination By Mr. Liberman:

Q. Mr. Ragsdale's questions seemed to cover Item 15 and 16 both, to some extent, are we just on 15 now? I just, this Item 15, Deferred State Income Taxes, can you tell me briefly what those items are? Is this just one item of State income tax or is it different kinds of normalization for, say, depreciation or payroll taxes, or other taxes? Is there any exhibit that shows me that?

A. None; no Staff exhibit. In my opinion, State income taxes is considered in all deferrals. Would you like to know which items are deferred? Would that help you?

Q. Yes, maybe that's what I am asking you.

A. Okay. Investment tax credit, the portion exceeding four percent.

Q. How much is that total investment tax credit for the tax year?

A. The Missouri portion, as adjusted, is $6,911,280.

Q. Is that the 11 percent allowed under the current tax law, or is it 10 percent?

A. That's four to 10 percent, sir.

Q. And there is another additional investment tax credit allowed, and I guess my question is then, is that involved in this case, or does the Company not take it?

A. I want to correct my last statement, it's four to 11 percent. cent.

Q. That last percent involves companies with plans, doesn't it, to some extent?

A. That's called employees' stock ownership plan, the additional one percent.

Q. Is there an expressly identifiable deferred income tax attributed to that?

A. Yes, there is. As I understand it, the Company is allowed an additional one percent investment tax credit and this one percent is turned around and distributed to the employees through a stock ownership plan.

Q. And how much is that?

A. What's the total?

Q. The dollar figure for the test year.

A. Okay; the total Company is $1,742,000. That's the total Company—you would have to multiply that by 72.85 to get the Missouri portion.

Q. Then that's part of that six million nine hundred eleven?

A. Yes, sir.

Q. Now, what I am not clear about still is how that relates to Missouri income taxes.

A. How does it relate?

Q. Yes; you indicated that that was an item, it was an item of deferred Missouri income taxes relating to this, as I understood you?

A. Yes, sir.

Q. What is the—number one, how much is that item, if you have an idea?

A. You have just heard it, sir.

Q. That's the Missouri tax item, that six million, or is it US?

A. I was talking about the employees' stock ownership plan.

Q. Right.

A. That is a portion of the previous figure. The first figure I gave you was the $6 million?

Q. Right.

A. That includes the Missouri portion of 1,742,000.

Mr. Smith: Can I ask a clarifying question?

Mr. Liberman: Yes.

Mr. Smith: Is that Federal, that six million dollars, is it Federal investment tax credit?

Witness Lewis: Yes, sir.

Mr. Smith: There is no state investment tax credit, is there?

Witness Lewis: No, sir.

Commissioner Jones: I think what he is getting at is how do all of these deferrals impact on the Company's State tax liability.

Mr. Smith: I think Mr. Liberman asked you both State and Federal.

Witness Lewis: Oh, I am sorry. I thought that's what you were asking, the Federal. Do you want to start over?

By Mr. Liberman:

Q. Well, I think we have got the Federal investment tax credit and what I want to ask you is how that relates to a deferred State income tax, or if it does? I understood your testimony to be that it did.

A. Excuse me. There is no investment tax credit for the State.

Q. All right. Let's get back to the deferred State income taxes, what are those?

A. Well, the Company provides separately, in the case of accelerated depreciation, they have a deferral for Federal and State. As far as my knowledge goes for the rest of the items, they have a 49.5 tax rate, and that is broken down into a Federal portion and a State portion. I don't have those figures broken out currently. They are just deferring them at a certain rate, which is 49.5.

Q. And then a certain portion of that is Missouri?

A. The State portion, yes.

Q. Okay. Could we just then list those, accelerated depreciation is done on a different basis than that, is that what you are saying?

A. It was just set out separately in my work papers.

Q. Why don't I get that?

A. I don't have it available right here.

Q. Okay. I would like that, if you can get it, for the test year, for the Federal and the State?

A. Yes, sir; that's the same information Mr. Ragsdale has requested.

Mr. Ragsdale: I didn't request anything for the Federal accelerated depreciation.

Witness Lewis: You want all deferred taxes broken out, Federal and State, is that the idea?

Mr. Liberman: Yes.

By Mr. Liberman:

Q. What I would like to know right now briefly is what other items we have under the 49.5.

A. Okay. Items that are capitalized per books, but are expenses for tax purposes, there are several of these items.

Q. Whatever comes under deferred.

A. I am just listing these. Repair allowance is one, expenses capitalized, which includes various expenses, pensions, payroll taxes, real estate and personal property taxes, sales and use tax, allowance for funds used during construction, the debt component there.

Q. Have you got a figure for each of those?

A. I have it for both Federal and State, for total company. I do not have the Missouri portion of each one.

Mr. Liberman: Okay.

Mr. England: Excuse me, Mr. Liberman, I am not sure, did you want the total or do you want the Missouri and the Federal, and I think we would have to provide that to you at a later time.

Mr. Liberman: Well, if he can provide it at a later time, I think it would save time for everybody to just do it that way.

Mr. England: We will provide you with that at a later time.

Mr. Liberman: And that will be broken down between Federal and State?

Mr. England: That's correct.

By Mr. Liberman:

Q. Can I just briefly go over these categories to see what they are, repair allowance, do you know what the consists of?

A. In previous years there has always been a controversy between corporations and the IRS as to the question of whether an item should be capitalized or whether it should be expenses.

Union Electric, in this particular case, has this problem, especially in the transmission and distribution area, in the small expenditures. Their repair allowance, briefly, allows Union Electric to capitalize, per books, the dollars in the standing work orders dealing with transmission and distribution, plant, while expensing for tax purposes an amount for your tax return.

So this is, once again, an item capitalized per books and expensed for tax purposes.

Commissioner Jones: And they don't recover any depreciation on that, as far as IRS is concerned, later on?

Witness Lewis: Yes, sir; it changes the tax and book basis, just like all of the other similar items do.

By Mr. Liberman:

Q. Well, I am still not exactly clear, most of these normalized expenses are a situation where—I see, they are collecting the tax now, but not paying it until later? What is the expense capitalized account that you just mentioned?

A. That various expenses capitalized, for the moment escapes me. It's a very minor amount and I will get that information for you later.

Q. Okay. The next one you mentioned was pensions, will you explain the nature of the tax deferral?

A. The same nature, items, pensions, pension expense associated with construction, it is capitalized per books while expensed for tax purposes. All of these items would have to be associated with construction because they are capitalized.

Q. All right. The payroll taxes too, that is simply the payroll taxes associated with construction?

A. Yes, sir.

Q. And the real estate and personal property, are those also associated with construction?

A. The same example, sir.

Q. Can you explain to me how real estate taxes are associated with construction?

A. Just because something is not in service doesn't mean the Company doesn't pay property taxes on it. In general, the assessment is usually half of the normal assessment, as if it were a plant in service, but they do pay property taxes. These are capitalized per books and expensed for your tax return.

Q. Now, this is not tax on land, is it? This is tax on construction in progress?

A. It is on land.

Commissioner Jones: It would be all property taxes they would pay on any construction project?

APPENDIX III

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

Case No. ER-77-154

In the matter of Union Electric Company of St. Louis, Missouri for authority to file revised tariffs reflecting increased rates for electric service provided to customers in the Missouri service area of the Company.

MOTION FOR REHEARING

Intervenor Utility Consumers Council of Missouri, Inc. moves the Commission to rehear this matter and reconsider its order for the following reasons:

* * *

7. The Commission erred in allowing the Company to normalize taxes because

a. taxes are an expense and to the extent that expenses are allowed in rates when there is no such expense, the Commission violates its statutory and constitutional duty to the ratepayers

b. it is untrue and unsupported by evidence or law that the Company's anticipated decline in construction will ever reach a point that it will not be able to replace existing facilities with newly depreciable facilities. The deferral of taxes created by accelerated depreciation will continue not only while the Company grows but so long as it remains constant in size and makes normal replacement of worn-out facilities. Only in the event that sales decline substantially will it ever be in a position of where there is a net of

tax depreciated items over newer not yet entirely depreciated items. The occurrence of this event is extremely unlikely in light of the evidence on which the Commission is allowing a rate of return sufficient to attract capital allegedly necessary for construction. Even if this event happened there would be no additional tax liability because the Company would be suffering severe losses, and would not need the depreciation deductions to avoid taxes.

c. the federal tax code did not require the normalization of accelerated depreciation tax savings, but at most prohibited a switch back to flow-through after a normalization method was elected. If the Company made such an election, the Commission is not bound by it.

d. the Congress does not have the power to compel a particular rate-making decision by this Commission and to the extent that any tax law of Congress does so, it is unconstitutional.

e. the fact that the Company may lose a deduction altogether does not justify the Commission in saddling the ratepayers with the expense, and the announcement and application of such a principle violates the statutory and constitutional duties of the Commission to set fair rates in this proceeding.

f. it is not correct that construction expenses are recognizable for taxing purposes in the year of expenditure. In most instances construction expenses must be capitalized, and no deduction is allowed. Thus there is no tax benefit associated with such expenses except depreciation which starts to occur when the construction is completed.

g. to the extent that the Company is allowed tax deductions for tax expenses related to construction and other

Schedule M deductions, these benefits should be passed on to the ratepayers in the year received, because the ratepayers are the ones for whom the tax collecting governments are collecting and spending the taxes in question.

Furthermore it is illusory to attempt to match such tax-savings to particular expenditures which may be capitalized, because a company's total income taxes are dependent on the interaction of income and expenses for a particular year and the effect in a future tax year may not in any way match the effect in a current tax year.

In addition ratepayers in the current year (or test year) are asked to bear a certain share of the costs of future construction by providing a rate of return sufficient to raise the necessary capital for such construction. This is particularly true where a large and increasing part of construction expenses are to be paid for by funds generated internally. To this extent the current ratepayers are entitled to the current tax-benefits even if you can meaningfully say that such benefits are related to future rate base items.

The denial of such tax benefits to current ratepayers forces them to pay expenses related to construction work in progress which is not yet in the rate base in violation of Proposition I. Similarly the normalization of Investment Tax Credit requires ratepayers to pay for non-used or useful property in violation of R.S.Mo., Sec. 393.135.

Respectfully submitted,

/s/ Samuel H. Liberman
Washington University School
of Law—Box 1120
St. Louis, MO 63130

Attorney for U.C.C.M.

APPENDIX IV

IN THE CIRCUIT COURT FOR THE CITY [SIC] OF COLE
STATE OF MISSOURI

No. 30233

State Of Missouri, *ex rel.*
Utility Consumers Council Of
Missouri, Inc.
Petitioner

v.

Public Service Commission
Of Missouri and Union
Electric Co.
Respondents

NOTICE OF APPEAL TO MISSOURI COURT OF APPEALS KANSAS CITY DISTRICT

Notice is given that Relator Utility Consumers Council of Missouri, Inc. appeals from the judgment entered in this action on the 31st day of May 1979 in the Circuit Court of Cole County, 19th Judicial Circuit, Division one, by James T. Riley, Circuit Judge.

JURISDICTIONAL STATEMENT

This is an appeal from a judgment of the Circuit Court affirming a Report and Order of the Public Service Commission of the State of Missouri pursuant to a Petition for Review thereof filed in accordance with Sec. 386.510, R.S.Mo. 1969. *This appeal does not involve the validity of a treaty or statute of the United States* or of a statute or provision of the constitution of the state, the construction of any revenue law or the title to any state office. The appeal is within the general jurisdiction of the Missouri Court of Appeals. Article V, Section 3, Constitution of Missouri, as amended 1976. (Emphasis added by Respondents)

A cost bond in the amount of $500.00 is filed herewith. A request for preparation of transcript has been made to Ms. Marilea Stadler, Court Reporter for Division one of the Circuit Court of Cole County.

/s/ Samuel H. Liberman
Washington University School
of Law—Box 1120
St. Louis, MO 63130

Attorney for Petitioner

Dated: June 12, 1979